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U.S. Securities & Exchange Commission v. Murphy

United States Court of Appeals, Ninth Circuit - October 4, 2022 - F.4th - 2022 WL 4866712

Securities and Exchange Commission (SEC) brought enforcement action against three investors, alleging violations of the Securities Exchange Act of 1934 section prohibiting unregistered brokers from effecting transactions in securities, § 10(b), and Rule 10b-5.

The United States District Court for the Southern District of California granted summary judgment in favor of SEC, and imposed civil penalties and injunctive relief. Investors appealed.

The Court of Appeals held that:

- Investors traded securities "for the account of others" and thus violated provision barring unregistered "broker" from trading securities;
- Provision barring any unregistered "broker" from trading securities was not unconstitutionally vague;
- Investor's knowing provision of false zip codes to municipal bond underwriters were "material misrepresentations" in violation of § 10(b) and Rule 10b-5;
- District court acted within its discretion in using number of months investor traded as unregistered broker to calculate total violations for purposes of determining amount of civil penalty;
- Civil monetary penalties did not violate Excessive Fines Clause;
- Injunction was warranted under the circumstances; and
- Injunction ordering defendant to comply with the Act was not insufficiently specific.

Investors who purchased municipal bonds at direction of owner of prime brokerage, with his capital, and shared portion of trading risk with him, traded securities "for the account of others," and thus were "brokers," within meaning of Securities Exchange Act of 1934, such that they violated the Act by failing to register with the Securities and Exchange Commission (SEC); investors put owner's capital at risk on every trade they made, contrary to investors' arguments, fact that they bore risk did not remove then from ambit of statute, and investors acted as owner's agents.

Provision of the Securities Exchange Act of 1934 barring any "broker" from trading securities without registering with the Securities and Exchange Commission (SEC) was not unconstitutionally vague, though unregistered broker asserted that neither statute nor SEC regulation provided fair notice that his trading arrangement, in which he bought municipal bonds as agent of owner of prime brokerage, with owner's capital, and shared a portion of the trading risk, required him to register as a broker; broker's conduct fell within text of the statute, and if he had concerns about the legality of his business arrangement, he could have requested clarification from the SEC in the form of a "No-Action Letter."

Investor's knowing provision of false zip codes to municipal bond underwriters to obtain highest retail priority for purchase of municipal bonds were "material misrepresentations" in violation of § 10(b) and Rule 10b-5, though investor asserted that underwriters had actual knowledge of her real zip code provided on her account registration forms and that there was no evidence underwriters

submitted false zip codes to issuers; issuers mainly relied on zip codes to determined retail priority order, any underwriters that examined forms would be left with two zip codes and no basis to discern truth from fraud, and misrepresentations were material even if not communicated to issuers.

Record supported district court's finding at remedies stage that investor committed 21 § 10(b) violations, based on the number of times she provided false zip codes to municipal bond underwriters to obtain highest retail priority for purchase of municipal bonds, in Securities and Exchange Commission (SEC) enforcement proceeding, though her liability turned on only three fraudulent transactions; at remedies stage, district court could consider more evidence to assess full extent of investor's misconduct so long as new evidence did not conflict with its liability findings, SEC submitted evidence of 21 conversations in which investor provided underwriters with false zip codes, and investor admitted to communicating 21 false zip codes.

District court acted within its discretion in using number of months investor traded as unregistered broker to calculate his total violations of provision of the Securities Exchange Act of 1934 barring any "broker" from trading securities without registering with the Securities and Exchange Commission (SEC) to determine amount of civil penalty in civil enforcement action brought by SEC; decision was especially reasonable, and favorable to investor, as district court could have found thousands of violations if it had relied on number of transactions he made as unregistered broker.

Record supported district court's finding that investor traded as unregistered broker for 46 months, in calculating his total violations of provision of the Securities Exchange Act of 1934 barring any "broker" from trading securities without registering with the Securities and Exchange Commission (SEC), to determine amount of civil penalty in civil enforcement action brought by SEC, though investor asserted that record contained just 12 months of trading data, where investor's trading logs, which were submitted to district court, confirmed 46 months of trading activity.

District court acted within its discretion in declining to consider civil penalties imposed on other defendants when imposing penalties on investors for violations of Securities Exchange Act of 1934 section prohibiting unregistered brokers from effecting transactions in securities, § 10(b), and Rule 10b-5, in enforcement action brought by Securities and Exchange Commission (SEC); comparison to settling defendants in same action who entered into consent decrees with SEC would be inapt because penalties resulted from bargained-for exchange, particularly since those defendants admitted wrongdoing, and comparison to defendants in separate actions would be inappropriate because circumstances varied so widely, and district could needed to perform individualized inquiry.

Civil monetary penalties of $414,090.40, $308,512.80, and $1,761,920, imposed against three investors, did not violate Excessive Fines Clause, in Securities and Exchange Commission (SEC) enforcement action in which investors were found to have violated Securities Exchange Act of 1934 section prohibiting unregistered brokers from effecting transactions in securities and one investor was found to have violated § 10(b) and Rule 10b-5; penalties were well within statutory maximum, investors made thousands of trades, which could have led to multimillion-dollar penalties, district court exercised its discretion in manner that led to substantially lower penalties, and, although there was no direct harm to individuals, violations caused systemic harm and were serious enough to warrant penalties imposed.

Injunction was warranted requiring defendants to disclose for five years a copy of complaint and final judgment in Securities and Exchange Commission (SEC) enforcement proceeding to any brokerage firm that they opened or maintained an account with, and permanently enjoining one defendant from future violations of Securities Exchange Act of 1934 section prohibiting unregistered brokers from effecting transactions in securities and the other from violating that section as well as § 10(b) and Rule 10b-5; defendants' current compliance with law did not render injunctive relief

unavailable, defendants remained engaged in securities industry, and district court found they had failed to fully appreciate wrongfulness of their conduct.

Injunction, which ordered defendant to comply with Securities Exchange Act of 1934 section prohibiting unregistered brokers from effecting transactions in securities, was not insufficiently specific on the ground that it merely directed defendant to comply with the law, in Securities and Exchange Commission (SEC) enforcement proceeding; the statutory terms were not impermissibly vague, and the injunction also referenced the district court's summary judgment decision finding liability, which provided defendant, a sophisticated actor, with additional guidance for his future conduct.

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